

TERRACE GARDENS, INC.  
(A California Nonprofit Public Benefit Corporation)

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ANNUAL FINANCIAL REPORT

DECEMBER 31, 2004 AND 2003

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Terrace Gardens, Inc.

We have audited the accompanying statement of financial position of Terrace Gardens, Inc., a California Nonprofit Public Benefit Corporation, as of December 31, 2004 and 2003, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Terrace Gardens, Inc. at December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles generally accepted in the United States of America.

  
Neeka Accountancy Corporation

Certified Public Accountants and Management Consultants  
Milpitas, California

March 18, 2005

TERRACE GARDENS, INC.

STATEMENTS OF FINANCIAL POSITION

December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<u>ASSETS</u>		
PROPERTY		
Land	\$ 1,565,277	\$ 1,565,277
Buildings and Improvements	11,601,281	11,601,281
Furnishings and equipment	277,859	277,859
Less: Accumulated Depreciation	<u>(3,935,780)</u>	<u>(3,682,460)</u>
Net property	9,508,637	9,761,957
OTHER ASSETS		
Cash and Cash Equivalent - Operating Accounts	15,065	14,231
Cash & Short-Term Investments		
Tenant security deposits	76,021	74,334
Replacement & Maintenance Reserves	953,611	917,143
Carillon fund	844	931
Tenants rents receivable	3,759	3,688
Deposits - Worker's Comp	4,627	3,028
Prepaid insurance	<u>41,276</u>	<u>46,082</u>
TOTAL ASSETS	<u>10,603,840</u>	<u>10,821,394</u>
<u>LIABILITIES AND NET ASSETS</u>		
LIABILITIES		
Accounts payable - trade	69,097	65,363
Accrued payroll and vacation	13,897	20,353
Tenant security deposits, including interest	76,312	74,597
Prepaid rents	<u>203</u>	<u>283</u>
Total Liabilities	159,509	160,596
NET ASSETS - UNRESTRICTED	<u>10,444,331</u>	<u>10,660,798</u>
TOTAL LIABILITIES AND NET ASSETS	<u>10,603,840</u>	<u>10,821,394</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

For the years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Income		
Gross potential rent	\$ 855,671	\$ 823,054
Guest rentals	7,260	7,140
Less vacancy loss	<u>(9,900)</u>	<u>(7,207)</u>
Net rental income	853,031	822,987
Interest income	4,547	21,627
Food service income	366,444	354,579
Other income	<u>2,729</u>	<u>4,761</u>
Total income	1,226,751	1,203,954
Operating expenses		
Administrative expense	222,183	214,013
Utilities	138,971	134,279
Operating and maintenance	257,002	275,474
Taxes and insurance	194,176	186,104
Food service contract	369,860	359,994
Recreation	<u>7,706</u>	<u>47,579</u>
Total operating expenses	1,189,898	1,217,443
Depreciation	253,320	258,120
Total expenses	1,443,218	1,475,563
Decrease in net assets	(216,467)	(271,609)
Unrestricted net assets - Beginning of year	10,660,798	10,915,239
Prior Period Adjustments	-	17,168
Unrestricted net assets - End of year	<u>10,444,331</u>	<u>10,660,798</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (Continued)

For the years ended December 31, 2004 and 2003

	2004	2003
<u>Administrative expenses</u>		
Advertising	\$ 5,580	\$ 556
Office Salaries	60,101	59,280
Office Supplies	16,720	18,967
Management fee	46,212	46,281
Manager's salary	61,448	57,463
Audit fee	4,685	4,500
Legal & Accounting	16,931	14,548
Telephone and answering service	9,007	7,605
Seminars and training	980	1,449
Miscellaneous administrative	519	3,364
Total administrative expenses	<u>\$ 222,183</u>	<u>\$ 214,013</u>
<u>Utilities</u>		
Electricity	65,613	69,706
Water	42,090	29,563
Gas	20,375	23,924
Sewer	10,893	11,086
Total utilities	<u>\$ 138,971</u>	<u>\$ 134,279</u>
<u>Operating and maintenance</u>		
Janitor payroll	33,863	45,339
Janitor and cleaning	13,496	12,135
Exterminating	970	4,065
Trash removal	18,527	18,527
Security and Fire Protection	11,709	9,315
Grounds contract and supplies	23,160	19,015
Repairs payroll	72,212	69,750
Repairs materials	9,265	16,497
Repairs contracts and replacements	48,438	31,128
Plumbing maintenance	1,618	13,988
Electrical maintenance	324	11,633
Elevator maintenance	9,829	8,876
Heating and cooling repairs	10,020	10,360
Painting contract and supplies	3,571	4,846
Total operating and maintenance	<u>\$ 257,002</u>	<u>\$ 275,474</u>

See accompanying notes to these financial statements.

TERRACE GARDENS, INC.

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (Continued)

For the years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<u>Taxes and insurance</u>		
Real estate taxes - special assessments only	\$ 6,675	\$ 6,515
Payroll taxes	\$ 21,182	23,045
Miscellaneous licenses and permits	55	582
Property and liability insurance	94,535	100,737
Workers' compensation	44,888	31,437
Health insurance and other employee benefits	26,841	23,788
Total taxes and insurance	<u>\$ 194,176</u>	<u>\$ 186,104</u>
<u>Food service contract</u>		
Food	369,860	359,994
Total food service contract	<u>\$ 369,860</u>	<u>\$ 359,994</u>
<u>Recreation expense</u>		
Salary	-	20,394
Supplies	2,176	6,008
Service coordinator salary	5,530	16,425
Miscellaneous recreation expense	-	4,752
Total recreation expense	<u>\$ 7,706</u>	<u>\$ 47,579</u>

See accompanying notes to these financial statements..

TERRACE GARDENS, INC.

STATEMENTS OF CASH FLOWS

For the years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Decrease in net assets	\$ (216,467)	\$ (254,441)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation	253,320	258,120
Decrease / (Increase) in current assets		
Tenant rents receivable	(71)	(419)
Prepaid insurance and taxes	3,207	(4,633)
Increase / (Decrease) in current liabilities		
Accounts payable	3,735	(11,178)
Prepaid rents	(81)	(621)
Security deposits	1,715	(2,676)
Accrued vacation	(6,455)	8,573
Net cash provided by operating activities	<u>\$ 38,903</u>	<u>\$ (7,275)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Building Improvements	0	0
Property & equipment additions	-	-
Reserves: Replacement, Maintenance & Other (Inc)/Dec	(38,069)	39,709
Net cash used in investing activities	<u>\$ (38,069)</u>	<u>\$ 39,709</u>
 <b>INCREASE / (DECREASE) IN UNRESTRICTED CASH</b>	 \$ 834	 \$ 32,434
<b>UNRESTRICTED CASH AT BEGINNING OF YEAR</b>	14,231	(18,203)
<b>UNRESTRICTED CASH AT END OF YEAR</b>	<u>\$ 15,065</u>	<u>\$ 14,231</u>

See accompanying notes to this financial statement.

TERRACE GARDENS, INC.  
(A Nonprofit Public Benefit Corporation)  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004 AND 2003

**NOTE 1 - ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES**

a) Organization - Terrace Gardens, Inc. is a California Nonprofit Public Benefit organization which was incorporated in the State of California on September 12, 1986. The Corporation is governed by a nine member board of directors, one of whom must be the City Manager of the City of Milpitas, or his appointee; one of whom must be a member of the City Council of the City of Milpitas; five of whom must be residents of the City of Milpitas; and the remaining members may be selected without regard to residence.

The Board of Directors' governing authority is limited by a Regulatory Agreement, dated November 17, 1987, between Terrace Gardens, Inc. and the City of Milpitas. Significant provisions of this agreement are described in Note 2.

b) Operations - The Corporation's purpose is to develop and manage the operations of a residential complex which consists of 148 rental units, 3 guest rooms, and 2 staff units, known as Terrace Gardens, which is located in the City of Milpitas and dedicated to the needs of elderly persons.

c) Property, Equipment and Depreciation - Land contributed by the City of Milpitas is reported in the financial statements at its estimated fair market value at the date contributed as determined by the County Assessor. Land improvements, buildings, building improvements and equipment are reported at acquisition cost less accumulated depreciation. Assets are depreciated on the straight-line basis over the following estimated useful lives:

Buildings	50 years
Building improvements	10 - 50 years
Equipment	5 - 7 years

On-going routine maintenance expenses related to equipment replacement at the residential units are expensed.

d) Income and Other Tax - The Corporation is exempt from federal income tax under section 501 (c) (3) of the Internal Revenue Code, and from California franchise tax under section 23710d of the California Revenue and Taxation Code. The Corporation is also exempt from Santa Clara County property taxes.

e) Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

TERRACE GARDENS, INC.  
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NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004 AND 2003

**NOTE 1 - ORGANIZATION, OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

f) Basis of Presentation – The presentation of the organization's financial statements complies with Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." Under SFAS No. 117, the organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. All the net assets of the organization are unrestricted.

Furthermore, information is required to segregate program service expenses from support expenses. General and administrative expenses consist of a portion of management fee, office supplies, auditing, bookkeeping and accounting. The costs of providing various programs and other activities are summarized on a functional basis as follows:

Program Services	\$1,219,410
Supporting Services	
General and administrative	223,810
	<hr/>
	\$1,443,220
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**NOTE 2 - REGULATORY AGREEMENT**

By agreement dated November 17, 1987 with the City of Milpitas, the Corporation is:

a) Prohibited from: using the land contributed to it by the City for any purpose other than constructing and operating the Terrace Gardens residential project; encumbering the land or project by any security interest; selling, assigning, conveying or otherwise transferring its interest in the project or project site; and from discriminating in any manner against any person on account of race, marital status, sex, religious creed, ancestry, national origin or physical handicaps in connection with constructing or operating the project.

b) Required to: maintain adequate insurance coverage; indemnify and hold harmless the City of Milpitas and its officials and employees against any actual or alleged liabilities resulting from any acts or omissions of the Corporation or its employees; submit operating budgets on or before the first day of each fiscal year to the City of Milpitas

TERRACE GARDENS, INC.  
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NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004 AND 2003

**NOTE 2 - REGULATORY AGREEMENT (Continued)**

for its approval; establish a reserve account for replacements and other project contingencies which must be funded at the rate of at least \$4,000 per month; limit occupancy in the project to persons 62 or more of age (in the case of joint occupancy at least one occupant must meet the age requirement) or 55 or more of age and handicapped; rent dwelling units by giving preference first to elderly residents and to elderly parents of residents of the City of Milpitas, and finally to residents of Santa Clara County not residing in Milpitas; limit rent in an amount not to exceed 30% of occupant's income, unless otherwise agreed by both the City and the Corporation, but in no event can the rent exceed the fair market rental value of the occupant's apartment (with the 2004 minimum to maximum monthly rent of \$356 to \$754); establish and maintain a surplus cash account, disbursements from which can only be made with the City's prior written approval and which must be disbursed to the City 30 days after receiving the City's written request for all or a portion of the surplus funds; and provide the City with annual financial statements audited by an independent certified public accountant.

<b><u>NOTE 3 - PROPERTY AND EQUIPMENT</u></b>	<b>2004</b>	<b>2003</b>
Buildings	\$ 11,400,858	\$ 11,400,858
Furniture	217,149	217,149
Office equipment	60,710	60,710
Improvements	200,423	200,423
	-----	-----
	11,879,140	11,879,140
Less accumulated depreciation	3,935,780	3,682,460
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	\$ 7,943,360	\$ 8,196,680
	=====	=====

**NOTE 4 - CASH EQUIVALENTS AND SHORT TERM INVESTMENTS**

Cash and cash equivalent assets totaled \$1,045, 539. These instruments consisted of:

- a) Cash, operating accounts, money market accounts, and certificates of deposit.
- b) Money market funds and certificate of deposits earned interests ranging from 0.15% to 2.15%, and had maturities of less than a year.

TERRACE GARDENS, INC.  
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DECEMBER 31, 2004 AND 2003

**NOTE 4 - CASH EQUIVALENTS AND SHORT TERM INVESTMENTS (Continued)**

- c) The Corporation maintains its cash balances at several financial institutions. Accounts at each institution are secured by the Federal Deposit Insurance Corporation up to \$100,000. As of December 31, 2004, all except three accounts have balances below \$100,000. The average balance of the three accounts that exceed \$100,000 is \$101,596.

**NOTE 5 - SURPLUS CASH (DEFICIT)**

Under Section 23 of its Regulatory Agreement dated November 17, 1987 with the City of Milpitas, Terrace Gardens, Inc. is required to remit surplus cash to the City upon receipt of 30 days written notice. Surplus cash is defined by that agreement as cash remaining after payment of all liabilities less amounts required for reserves and contingencies. On this basis, surplus cash as of December 31, 2004 is computed as follows:

Cash and short-term investments	\$ 1,045, 539
Less:	
Accounts payable (operating)	(69,097)
Accrued payroll and vacation	(13,897)
Tenants security deposits	(76,312)
Replacement & Maintenance Reserves	(953,611)
Carillon Fund	(844)
	-----
Total surplus/(deficit) cash	\$ (68,222)
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TERRACE GARDENS, INC.  
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NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004 AND 2003

**NOTE 6 - FUTURE MAJOR REPAIRS AND REPLACEMENTS**

The Corporation's governing documents require funds to be accumulated for future major repairs and replacements. Accumulated funds, which aggregate approximately \$953,611 at December 31, 2004, are held in separate accounts and are generally not available for operating purposes. It is the Corporation's policy to retain the interest earned on such funds in the reserve for replacement and other contingency accounts.

The Corporation in 2003 engaged an independent engineer to update the April 2000 reserve study to estimate the remaining useful lives and the replacement costs of the common property components.

The Corporation is expected to continue funding such major repairs and replacements over the estimated useful lives of the components based on the new study's estimates of current replacement costs, considering amounts previously accumulated. Actual expenditures, however, may vary from the estimated amounts and the variations may be material. Efforts are underway by management to ensure sufficient funds are set aside to meet repairs and replacements identified in the updated reserve study.